

## ANALYSIS OF AMENDED BILL

Author: Knight Analyst: Jeani Brent Bill Number: SB 1631  
Related Bills: See Legislative History Telephone: 845-3410 Amended Date: 03/26/98  
Attorney: Doug Bramhall Sponsor: \_\_\_\_\_

**SUBJECT:** Eastern Kern County Enterprise Zone

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended \_\_\_\_\_.

AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended \_\_\_\_\_.

FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO \_\_\_\_\_.

REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED/AMENDED \_\_\_\_\_ STILL APPLIES.

☒ OTHER - See comments below.

### SUMMARY OF BILL

Under the Government Code, this bill would require the Trade and Commerce Agency (TCA) to designate an additional enterprise zone in eastern Kern County.

This bill would provide that all tax incentives provided to existing enterprise zones under the Revenue and Taxation Code would apply to the enterprise zone designated under this bill.

### SUMMARY OF AMENDMENT

The March 26, 1998, amendment deleted the bill's prior legislative intent language and inserted the provisions discussed in this analysis.

### EFFECTIVE DATE

This bill would be operative on January 1, 1999.

### LEGISLATIVE HISTORY

AB 1937, AB 2205, SB 2079 (1998); AB 69, AB 82, AB 797 (Stats. 1997, Ch. 461), AB 1217 (Stats. 1997, Ch. 602), SB 200 (Stats. 1997, Ch. 609), SB 635, SB 965 (Stats. 1997, Ch. 603); AB 2456 (1996), AB 296 (Stats. 1996, Ch. 953), SB 715 (Stats. 1996, Ch. 952), SB 2023 (Stats. 1996, Ch. 955); SB 712 (Stats. 1995, Ch.

DEPARTMENTS THAT MAY BE AFFECTED:

\_\_\_ STATE MANDATE

\_\_\_ GOVERNOR'S APPOINTMENT

Board Position:

\_\_\_ S \_\_\_ O  
\_\_\_ SA \_\_\_ OUA  
\_\_\_ N \_\_\_ NP  
\_\_\_ NA \_\_\_ NAR  
☒ PENDING

Agency Secretary Position:

\_\_\_ S \_\_\_ O  
\_\_\_ SA \_\_\_ OUA  
\_\_\_ N \_\_\_ NP  
\_\_\_ NA \_\_\_ NAR  
DEFER TO \_\_\_\_\_

**GOVERNOR'S OFFICE USE**

Position Approved \_\_\_  
Position Disapproved \_\_\_  
Position Noted \_\_\_

Department/Legislative Director Date  
Gerald H. Goldberg 4/15/98

Agency Secretary Date

By: Date:

494); AB 2206 (Stats. 1994, Ch. 853), SB 1438 (Stats. 1994, Ch. 754), SB 1770 (Stats. 1994, Ch. 755).

#### PROGRAM HISTORY/BACKGROUND

California has five types of economic development areas that have similar tax incentives:

- Enterprise Zones,
- Los Angeles Revitalization Zone (LARZ),
- Local Agency Military Base Recovery Areas (LAMBRA),
- Targeted Tax Area (TTA), and
- Manufacturing Enhancement Areas (MEA).

The following table shows the incentives available to each of the economic development areas.

Types of Incentives	EZ	LARZ*	LAMBRA	TTA	MEA
Sales or Use Tax Credit	X	X	X	X	
Hiring Credit	X	X	X	X	X
Construction Hiring Credit		X			
Employee Wage Credit	X				
Business Expense Deduction	X	X	X	X	
Net Interest Deduction	X	X			
Net Operating Loss	X	X	X	X	

\* NOTE: the LARZ expires December 1, 1998.

#### SPECIFIC FINDINGS

**Under the Government Code, existing state law** allows the governing body of a city or county to apply for designation as an enterprise zone. Using specified criteria, TCA designates enterprise zones from the applications received from the governing bodies. Enterprise zones are designated for 15 years, and TCA has designated the 39 enterprise zones authorized under existing law. Three of the existing enterprise zones are located in Kern County: Delano, Shafter, and South East Bakersfield.

**Under the Revenue and Taxation Code, existing state law** provides special tax incentives for taxpayers conducting business activities within enterprise zones. These incentives include a sales or use tax credit, hiring credit, business expense deduction, and special net operating loss treatment. Additionally, the Enterprise Zone Act provides incentives to taxpayers other than those operating in the enterprise zone: a net interest deduction for businesses that make loans to businesses within the enterprise zone and a tax credit for employees working in an enterprise zone. See Attachment A for a detailed discussion of each tax incentive.

**SB 1631** would require the TCA to designate an additional enterprise zone in eastern Kern County.

**This bill** would specify that all tax incentives provided to existing enterprise zones under the Revenue and Taxation Code would apply to the new enterprise zone designated under this bill.

### Policy Considerations

This bill does not specify the potential size of the area to be designated as an enterprise zone. Thus, the entire eastern portion of Kern County could be designated.

This bill does not specify the duration of the enterprise zone designation that would be provided under this bill.

### Implementation Consideration

Implementing this bill would require changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

## FISCAL IMPACT

### Departmental Costs

This bill would not significantly impact the department's costs.

### Tax Revenue Estimate

The revenue loss from this bill is estimated as follows:

SB 1631 Assumed Effective After December 31, 1998 (In Millions)		
1999-0	2000-1	2001-2
Negl. Loss *	Minor Loss **	(\$1)
* Less than \$250,000      ** Less than \$500,000		

### Revenue Estimate Discussion

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue losses under the Personal Income Tax Law and the Bank and Corporation Tax Law would depend on the number of businesses that would purchase qualified property subject to the sales tax, the amount of wages paid to qualifying employees, and the state tax liabilities of employers claiming tax benefits.

Because the effectiveness of a new zone is unknown and the potential exists for significant businesses to locate in a zone, the average revenue loss of \$1 million per zone per year has been used. (For the 1995 tax year, the total revenue loss for the 37 existing zones was \$37 million.) However, the cumulative loss for the first two years is expected to be less than \$500,000.

## BOARD POSITION

Pending.

SENATE BILL 1631  
As Amended March 26, 1998  
Attachment A

ENTERPRISE ZONE TAX INCENTIVES

**Sales or Use Tax Credit**

The enterprise zone sales or use tax credit is allowed for an amount equal to the sales or use taxes paid on the purchase of qualified machinery purchased for exclusive use in an enterprise zone. The amount of the credit is limited to the tax attributable to enterprise zone income. Qualified machinery is defined as machinery and machinery parts used to (1) manufacture, process, combine, or otherwise fabricate a product; (2) produce renewable energy resources; or (3) control air or water pollution. In addition, qualified machinery must be purchased and placed in service before the enterprise zone designation expires. The maximum value of property that may be eligible for the enterprise zone sales or use tax credit is \$1 million for individuals and \$20 million for corporations.

**Hiring Credit**

A business located in an enterprise zone may reduce tax by a percentage of wages paid to qualified employees. A qualified employee must be hired after the area is designated an enterprise zone and meet certain other criteria. At least 90% of the qualified employee's work must be directly related to a trade or business located in the enterprise zone and at least 50% must be performed inside the enterprise zone. The business may claim up to 50% of the wages paid to a qualified employee as a credit against tax imposed on enterprise zone income. The credit is based on the lesser of the actual hourly wage paid or 150% of the current minimum hourly wage. The amount of the credit must be reduced by any other federal or state jobs tax credits and the taxpayer's deduction for ordinary and necessary trade or business expenses must be reduced by the amount of the hiring credit.

**Business Expense Deduction**

A business located in an enterprise zone may elect to deduct as a business expense a specified amount of the cost of qualified property purchased for exclusive use in the enterprise zone. The deduction is allowed in the taxable year in which the taxpayer places the qualified property in service. The basis of the property must be reduced by the amount of the deduction. The maximum deduction for all qualified property is the lesser of 40% of the cost or the following:

If the property was placed in service:

Months after designation	Maximum deduction
0 to 24	\$40,000
25 to 48	30,000
48 and over	20,000

### **Net Operating Loss Deduction**

A business located in an enterprise zone may elect to carry over 100% of the enterprise zone net operating losses (NOLs) to deduct from enterprise zone income of future years. The election must be made on the original return for the year of the loss. The NOL carryover is determined by computing the business loss that results from business activity in the LAMBRA.

### **Net Interest Deduction**

A deduction from income is allowed for the amount of net interest earned on loans made to a trade or business located in an enterprise zone. Net interest is defined as the full amount of the interest less any direct expenses (e.g., commission paid) incurred in making the loan. The loan must be used solely for business activities within the enterprise zone and the lender may not have equity or other ownership interest in the enterprise zone trade or business.

### **Employee Wage Credit**

Certain disadvantaged individuals who are allowed a credit for wages received from an enterprise zone business. Public employees are not eligible for the credit. The amount of the credit is 5% of "qualified wages," defined as wages subject to federal unemployment insurance. For each dollar of income received by the taxpayer in excess of qualified wages, the credit is reduced by nine cents. The credit is not refundable and cannot be carried forward. The amount of the credit is limited to the amount of tax that would be imposed on income from employment in the enterprise zone, computed as though that income represented the taxpayer's entire taxable income.